



(23)  
IN THE

**Supreme Court of the United States**

OCTOBER TERM 1941

No. **1196**

In the Matter of  
**PRUDENCE-BONDS CORPORATION,**

*Debtor.*

In Proceedings for Reorganization under Section 77B  
of the Bankruptcy Act.

In the Matter of the judicial settlement of the account of proceedings  
of Manufacturers Trust Company, as Successor Trustee of Prudence-  
Bonds, Twelfth Series, under Trust Agreement dated February 1,  
1928, between Prudence-Bonds Corporation and Chatham Phenix  
National Bank and Trust Company, as Trustee.

**MANUFACTURERS TRUST COMPANY,**  
against

*Petitioner,*

**CHARLES H. KELEY and CLIFFORD S. KELSEY, Trustees of the Debtor,**  
**PRUDENCE-BONDS CORPORATION (New Corporation), MARY KEANE**  
**et al., GEORGE E. EDDY and PRUDENCE SECURITIES ADVISORY GROUP.**

**RESPONDENTS' BRIEF IN OPPOSITION TO  
PETITION FOR WRIT OF CERTIORARI**

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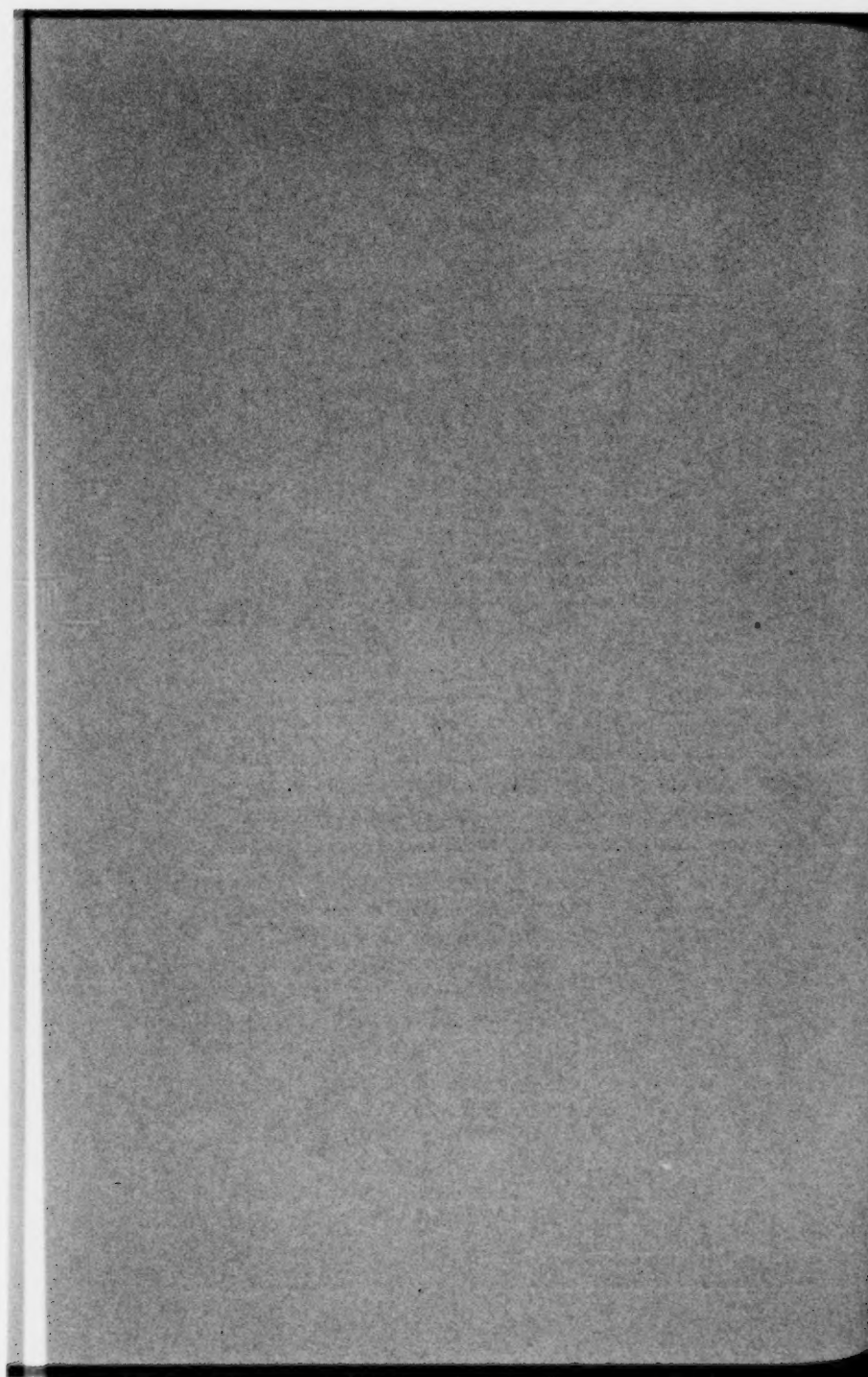
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Dated: New York, May 19, 1942.



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In the Matter of the judicial settlement of the account of  
proceedings of Manufacturers Trust Company, as Suc-  
cessor Trustee of Prudence-Bonds, Twelfth Series, under  
Trust Agreement dated February 1, 1928, between Pru-  
dence-Bonds Corporation and Chatham Phenix National  
Bank and Trust Company, as Trustee.

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MANUFACTURERS TRUST COMPANY,  
Petitioner,  
against

CHARLES H. KELBY and CLIFFORD S. KELSEY, Trustees of the  
Debtor, PRUDENCE-BONDS CORPORATION (New Corporation),  
MARY KEANE et al., GEORGE E. EDDY and PRUDENCE SECURI-  
TIES ADVISORY GROUP.

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**RESPONDENTS' BRIEF IN OPPOSITION TO  
PETITION FOR WRIT OF CERTIORARI**

### Opinions Below

The opinion of the Circuit Court of Appeals (R. 519) is reported in 125 F. (2d) 650.\*

The opinion of the District Court (R. 500) is not reported.

The opinion of the Special Master is not reported but is printed in the record (R. 333).

### Jurisdiction

The opinion of the Circuit Court of Appeals was rendered February 3, 1942, and the decree and order for the mandate thereon was entered February 24, 1942.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. Code, Title 28, Sec. 347).

### Questions Presented

Petitioner, acting as trustee of an express trust under a written trust agreement, held a trust fund to secure bonds of the Debtor. Upon confirmation of the Plans in a proceeding for the reorganization of the Debtor corporation under Section 77B of the Bankruptcy Act, the District Court, in order to make effective, consummate and carry

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\* The Circuit Court of Appeals on a prior appeal herein, to which petitioner was a party, upheld the jurisdiction of the bankruptcy court over petitioner's account and the accounts of the other Corporate Trustees of the Debtor's bond issues, and over objections based upon the Trustees' acts in wrongfully diverting and disbursing the Trust Funds in violation of the Trust Agreements. This opinion of the Circuit Court of Appeals is not printed in this record, but is reported *sub nom.*, *Central Hanover Bank & Trust Co. et al. v. President & Directors of the Manhattan Co. et al.*, 105 F. (2d) 130. The opinion of the District Court in that case is not reported and is not printed in this record.

out the Plans, approved a Modified or Supplemental Trust Agreement, appointed a Successor Trustee, authorized and directed petitioner to transfer and deliver the Trust Fund to its Successor Trustee and to account in the reorganization proceeding for its acts as Trustee. The Supplemental Trust Agreement relieved the Successor Trustee of any responsibility for the acts or omissions of its predecessor and of any obligation to take any action against its predecessor. Objections to petitioner's account were filed by respondents on their own behalf and on behalf of all bondholders, charging that petitioner, while acting as such Trustee, had wrongfully diverted and disbursed cash and securities constituting part of the Trust Fund in violation of the Trust Agreement. The questions are:

1. Whether the Court below correctly applied and interpreted New York law in holding that petitioner's liability is to restore the trust *res*.
2. Whether the Court below correctly held that the objections are not barred by any statute of limitations.
3. Whether the bankruptcy court has jurisdiction over the subject matter of the objections.

### Statement

Petitioner, we submit, has omitted material facts which conclusively demonstrate that it is a trustee of an express trust, rather than a mere depositary or custodian as it contends. Petitioner also questions the jurisdiction of the bankruptcy court. In the Courts below it expressly represented that it did not question such jurisdiction (R. 246), and in its statement of points to be relied upon, it specifically excluded from the issues on the appeal, the jurisdictional issue it now here raises (R. 505). We, therefore, cannot accept petitioner's statement of the case.

The agreement under which petitioner acted, is described in the instrument itself as a "Trust Agreement" (R. 24).

It recites that the Debtor "has determined to establish a Trust Fund" to secure the payment of the Bonds "at any time issued and outstanding" (R. 25). It Witnesseth that the Debtor "has granted, bargained, sold, assigned, transferred, and set over" (R. 25-26) the Trust Fund to the Trustee "to have and to hold said Trust Fund upon the trusts hereby created for the equal and pro rata benefit and security of the holders of Prudence-Bonds, Twelfth Series, issued and to be issued hereunder and to secure the payment of the principal and the interest of said bonds and for all the other uses and purposes and upon the terms and conditions herein declared and expressed" (R. 26). It then provides that the Trust Fund is "for the equal and pro rata benefit and protection of the holders of Prudence-Bonds, Twelfth Series at any time issued and outstanding under this agreement, irrespective of the time of issuance of any such Prudence-Bonds or of the date of the assignment to and deposit with the Trustee of the securities and cash constituting the same" (R. 26). It is further provided, that all Bonds "shall be secured by the Trust Fund irrespective of the actual date of their issuance and negotiation" (R. 37), and that the Trustee's certificate of authentication on the Bonds "shall be conclusive evidence that the bond so authenticated has been duly issued hereunder and is entitled to the benefit of the trusts hereby created" (R. 43).

Under an Article entitled "Concerning the Trust Fund", it is provided that the Fund shall consist of bonds and first mortgages, corporate bonds and notes secured by first mortgages or deeds of trust, U. S. Government securities and other securities legal for trust funds, including cash (R. 26-28, 336).

The Trust Agreement also provided that petitioner's compensation "shall not be limited by any provision of law in regard to the compensation of a trustee of an express trust" (R. 62). It also provided that a Successor Trustee was required to be a New York trust company, or a

national bank, "lawfully authorized to accept and execute trusts" (R. 63).

The Trust Agreement further specifically provided that each bond, note, trust deed and all other securities, except cash, should by separate writing be assigned or endorsed over to the Trustee (R. 27-28). The assignments were executed and physically delivered to the Trustee, accompanied by the securities themselves (R. 362-364). Mortgages in the Trust Fund have been foreclosed, titles have been conveyed, mortgages have been extended and titles to real estate have been insured in reliance upon petitioner's sworn statements that it was the owner and holder of bonds and mortgages forming part of the Trust estate (R. 295, 298, 303-305, 308-313, 442-443). Legal title to cash forming part of the Trust Fund was passed to petitioner by the Trust Agreement itself and by actual delivery of the cash (R. 363-364).

Under the Trust Agreement the Debtor's right to deal with the securities in the Trust Fund was at all times subject to the express conditions and limitations contained therein (R. 34-37). The Courts below have held that petitioner had affirmatively agreed to watch over and to protect the Trust Fund "against any unchartered incursion by the Debtor" (R. 345).

In its verified petition for the judicial settlement of its account, petitioner sets forth that it is "duly authorized and empowered to hold in trust the properties held by it in and by the Trust Agreement hereinafter mentioned and to execute the trusts created thereby" and that as "Trustee under the foregoing Trust Agreements, your petitioner has administered the trusts therein set forth" (R. 74).

The Courts below found that petitioner had actual possession of and legal title to the Trust Fund (R. 443, 444, 446); that petitioner is a trustee of an express trust (R. 525, 502, 476) and that it "was never a mere depository and agent for" the bondholders (R. 445). The Courts below further found that the Trust Agreement has not been satis-

fied or annulled (R. 451) and that the "Trust created" has "never been repudiated" to the knowledge of the bondholders (R. 450).\*

The seventeen (17) other Trust Agreements made by the Debtor to secure its other Series of Bonds were, with variations not here material, substantially like the one here involved (R. 364).

The order made on June 29, 1934, approving the Debtor's petition for reorganization restrained suits against the Debtor and its property (R. 365-368). Shortly thereafter, the District Court enjoined a number of suits for accountings brought by bondholders in the State Courts against petitioner and most of the other Corporate Trustees (R. 427-431). One of the injunction orders was appealed and upheld by the Circuit Court of Appeals (*In re Prudence-Bonds Corporation*, 75 F. [2d] 262). In applying for the injunction order which was upheld in the case just cited, Chemical Bank and Trust Company, Trustee of the Fifteenth Series, stated in its petition verified October 9, 1934, that the "accounting asked for by said complaint is similar to the accounting that your petitioner, the Corporate Trustee, will make at the proper time to this Court" (R. 429) and that "such accounting to another court would be highly inappropriate" (R. 430). On another appeal taken at about the same time to the Circuit Court of Appeals from an order made in the reorganization proceedings on February 8, 1935 (*In re Prudence-Bonds Corporation*, 77 F. [2d] 328), counsel for the petitioner and counsel for several other Corporate Trustees, in supporting the Court's right to enjoin the State Court accounting actions, pointed out to the Court that "presumably the Trust Companies will be required to account in the bankruptcy court for their acts as trustees under the respective trust indentures" (R. 430-431).

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\* There are outstanding approximately 6900 Twelfth Series bonds, of the aggregate principal amount of \$4,358,300, held by approximately 2800 bondholders residing in New York State and elsewhere (R. 369). Prior to the reorganization, most of these bonds were bearer bonds; some still are (R. 369-370).

The Debtor then proposed a separate Plan for each of its eighteen (18) Series of Bonds and a so-called General Plan of Reorganization providing for the *modus operandi* of carrying out the separate Series Plans (R. 370). Both the Debtor and The Prudence Company, Inc., the Guarantor, were subsequently found to be insolvent (R. 365, 370). The Plans were confirmed (R. 371), the General Plan providing for the formation of a new corporation to be wholly owned by the bondholders (R. 377). Each separate Series Plan provided for a Modified or Supplemental Trust Agreement (R. 375-377). The Effective Date was fixed as March 1, 1938 (R. 378).

As part of the proceedings to make effective, consummate and carry out the Plans, the District Court:

(a) Approved the appointment of City Bank Farmers Trust Company\* as Trustee of each of the eighteen (18) Series of Bonds under a Supplemental Trust Agreement for each Series;

(b) Approved the form of Supplemental Trust Agreement;

(c) Authorized and directed the Debtor and its 77B Trustees to assign all their right, title and interest in the Trust Fund collateral securing the eighteen (18) Series of Bonds to the New Corporation; and

(d) Authorized and directed the Corporate Trustees under the original Trust Agreements to assign, convey and deliver their respective Trust Funds to City Bank Farmers Trust Company, as Trustee under the Supplemental Trust Agreements, and to file accounts of their respective acts as Trustees and to make application for the judicial settlement thereof (R. 378-388).

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\* City Bank Farmers Trust Company was Trustee under five of the original Trust Agreements (R. 383).

Neither petitioner nor any of the other Corporate Trustees objected to or appealed from the order authorizing and directing them to account (R. 160).

The Plan of Reorganization for the Twelfth Series specifically provided that the rights and claims of bondholders other than their rights and claims against The Prudence Company, Inc., upon its guarantee, shall be "preserved" and that the Modified or Supplemental Trust Agreement "shall contain appropriate provisions, consistent with the Plan for their preservation and enforcement" (R. 375). As to bondholders' rights against the Guarantor, the Plan provided that such rights "are reserved unto them" (R. 376).\*

Each Supplemental Trust Agreement accordingly provides that the bondholders' rights against the Guarantor "are reserved unto them" and that their "preserved" rights "shall be deemed for all purposes in full force and effect and may be enforced in accordance with the Original Trust Agreement as hereby amended" (R. 395). The Supplemental Trust Agreements vest the New Corporation, which had assumed payment of the bonds (R. 191, 451), with the power "to demand, receive, sue for and recover all moneys and other properties and rights forming part of the Collateral and to give full acquittances therefor" (R. 392). Each Supplemental Trust Agreement (except those in the five Series in which City Bank Farmers Trust Company continued as Trustee), also provides that City Bank Farmers Trust Company, the Successor Trustee, "shall not be responsible in any manner whatsoever for the acts or omissions of its predecessors as trustee under the Original Trust Agreement" and "shall not be required to institute any actions, legal or equitable, against any of its predecessors as trustee under the Original Trust Agreement" (R.

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\*The bondholders' rights against the Debtor having been reorganized and their rights against the Guarantor having been "reserved unto them" (R. 376), their only remaining or "preserved" rights were to the Trust Funds and against the Corporate Trustees.

390, 218). This last provision had been inserted with the approval of the District Court, at the request of City Bank Farmers Trust Company and as a condition to its acceptance of the Trusts under the Supplemental Trust Agreements (R. 389).

In the fall of 1938, the Corporate Trustees filed their accounts and respectively petitioned the District Court for their discharge from all responsibility with respect to their acts and proceedings as Trustees from the inception of the Trusts, and with respect to all matters contained in their accounts (R. 403). Thereupon, a question was raised as to the jurisdiction of the bankruptcy court (R. 414). The District Court decreed it had no jurisdiction over the accounts or any objections thereto, in so far as they related to acts of the Corporate Trustees prior to the date of the commencement of the reorganization proceeding, in permitting the Debtor to substitute or withdraw Trust Fund securities in alleged violation of the Trust Agreements (R. 209-211, former record \*). The Court, however, directed that an appeal be taken so that "this question of jurisdiction may be finally determined and any expense and delay entailed thereby justified" (R. 201, former record). Upon the appeal the order of the District Court was unanimously reversed (*Central Hanover Bank & Trust Co. et al. v. President and Directors of the Manhattan Co. et al.*, 105 F. [2d] 130).

Upon the mandate of the Circuit Court of Appeals, the District Court then made an order on July 12, 1939, reversing its former order and decreeing that "to make effective, consummate and carry out" the confirmed Plans, it had and thereby took full, complete and exclusive jurisdic-

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\* Record on appeal, *Central Hanover Bank & Trust Co. et al. v. President & Directors of the Manhattan Co. et al.*, 105 F. (2d) 130, herein referred to as "former record". In the Circuit Court of Appeals this record was incorporated into the present record by reference as it was on file there (R. 203), but it has not been filed with this Court on the present petition.

tion over the accounts and all objections thereto (R. 206-207). Such order provided that any objections of the New Corporation and the 77B Trustees of the Debtor would be deemed and constituted to be made on their own behalf and on behalf of the bondholders, authorized bondholders to join in and adopt objections of the New Corporation and the 77B Trustees of the Debtor and continued the stay of all other accounting suits (R. 207-208).

The objections filed by respondents to petitioner's account are specifically made on behalf of the Objectors therein named and on behalf of all bondholders (R. 106-132).

The accounts and objections were subsequently referred to a Special Master (R. 427).

The objections charge that petitioner, as Trustee, released and disbursed, in violation of express provisions of the Trust Agreement, particularly Section 6 of Article I (R. 34), securities and cash constituting part of the Trust Fund (R. 106-132). The charge made must here be deemed true, no inquiry or trial on the merits having yet been had (R. 526, 447, 333).

While objections in other Series were being tried on the merits (R. 333), petitioner moved for an order dismissing the objections to its account, and for summary judgment approving its account, solely upon the grounds that none of the Objectors had any status to file the objections and that the objections were barred by the New York Statute of Limitations (R. 12).

Petitioner's motion was in all respects denied (R. 10). Petitioner appealed and the Circuit Court of Appeals in the decision now sought to be reviewed unanimously affirmed the order of the District Court (R. 519).

## I

**The Circuit Court of Appeals has applied and correctly interpreted New York law in holding that in the situation here presented petitioner's liability is to restore the trust *res*.**

Before discussing the New York law applicable to trustees in the circumstances here, we shall refer briefly to decisions making it clear beyond argument that the Courts below correctly decided that under the law of New York petitioner is a trustee of an express trust (R. 525, 502).

## A

**The Trust Agreement created an express trust.**

In New York an express trust is a trust created by expression or intentional act of the parties as distinguished from one created by operation of law (*Hammerstein v. Equitable Trust Co.*, 156 App. Div. 644; *Pomeroy's Equity Jurisprudence* [4th Ed.], vol. 1, sec. 152; *Perry on Trusts* [7th Ed.], vol. 1, sec. 24). The only requirements of an express trust of personal property such as here involved are, "'(1) a designated beneficiary; (2) a designated trustee who must not be the beneficiary; (3) a fund or other property sufficiently designated or identified to enable title thereto to pass to the trustee, and (4) the actual delivery of the fund or other property, or of a legal assignment thereof to the trustee, with the intention of passing legal title thereto to him as trustee'" (*Brown v. Spohr*, 180 N. Y. 201, 209). As stated in *Perry on Trusts*, *supra*, "As express trusts are directly declared by the parties, there can never be a controversy whether they exist or not."

There should not be any controversy as to whether this Trust Agreement created an express trust, because it was

directly declared and expressed by the parties. And it clearly appears (*supra*, pp. 3-6) that the four essential elements of an express trust are here present.

In *Prudence Co., Inc. v. Central Hanover Bank & Trust Co.*, 237 App. Div. 595 (affd. 261 N. Y. 420), the Court in construing a similar Trust Agreement of The Prudence Company, Inc., stated (p. 600):

"The bank is not a depository. It is a trustee. Its duty is to make certain, so far as possible, that the trust shall attain its end."

In *In re Prudence-Bonds Corporation*, 75 F. (2d) 262, the Circuit Court of Appeals, in passing upon the relationship created by the Trust Agreement securing Prudence-Bonds, Fifteenth Series, stated (p. 263):

"But the pledgee at bar though in possession is not an ordinary pledgee; it is a trustee, bound by the terms of the deed to act only in the interest of its beneficiaries, the bondholders."

In *In re The Prudence Company, Inc.*, 82 F. (2d) 755, the Circuit Court of Appeals stated (p. 755):

"Each of the appellants is the trustee under one or more trust agreements executed by Prudence-Bonds Corporation under which certain mortgages on real estate and other securities were assigned to the appellants to hold in trust upon the terms stated for the benefit of the owners of bonds issued by Prudence-Bonds Corporation in accordance with the trust agreement."

It conclusively appears, therefore, that the Trust Agreement here involved created an express trust. As the Circuit Court of Appeals stated (R. 525):

"Finally, there can be no doubt that the instrument creating this 'series' set up an 'express trust'; it is

exceptionally explicit, and is replete with language that admits of no other interpretation. A precisely similar deed was held to create a trust in *Manhattan Co. v. Prudence Co.*, 266 N. Y. 202."

Despite these conclusive decisions that the petitioner is a trustee of an express trust, it still maintains that it is a mere depositary or custodian, and that legal title to the Trust Fund securities was in the Debtor. This is an astonishing position for the petitioner to take, in view of the fact that it, in conjunction with Corporate Trustees of other Series of Bonds of the Debtor, filed a brief as *amici curiae* in the case cited by the Circuit Court of Appeals (*Manhattan Co. v. Prudence Co.*, *supra*), urging that legal title to the Trust Fund collateral was in the plaintiff as Trustee (see also R. 175-178). The Court of Appeals there held that a trust was created and that legal title to the Trust Fund was in the plaintiff as Trustee.\*

One moment the petitioner is urging that the New York law applies to the issues in this case, and the next moment we are asked to forget that the highest State Court ruled, at the request of petitioner, that it was a trustee owning and holding the legal title in trust for the bondholders.

There can be but one explanation for this unusual conduct on the part of the petitioner. In the hope of bringing itself within the rulings of the State Courts in cases involving mortgage certificate issues of New York title companies, it now wishes to have it held that it is a mere depositary or custodian, that there is no trust, and that it did not have legal title. These certificate issue cases, which are discussed *infra* in Point II, have been distinguished by the Circuit Court of Appeals from the instant case.

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\* The plaintiff in that case was Trustee of Prudence-Bonds, Fifth and Ninth Series.

## B

In New York the law is settled that upon an accounting, the liability of a trustee who has wrongfully depleted or disbursed a trust fund is to restore and replenish the fund. The right to enforce this liability is a derivative one and, in the case of a corporate bond issue, such liability can be enforced on behalf of all bondholders, irrespective of when they acquired their bonds.

Petitioner's first contention is that a trustee holding a trust fund to secure the payment of corporate trust bonds is not, under the law of New York, liable on an accounting to restore to the fund cash and the value of any other trust property wrongfully diverted or disbursed from the Fund by the trustee in violation of the express provisions of the trust instrument.\* It is petitioner's position that in such

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\* After contending throughout that an individual action at law for damages is the only remedy available to bondholders and that such remedy is barred by the Statute of Limitations, petitioner ends its brief with the statement that (Petitioner's Br., p. 33):

"The present controversy properly belongs, we submit, in the State court having jurisdiction over the indenture trustee, *to which such trustee is required to account and the law of which must in any event determine the result.*" (Italics ours.)

When such statement is viewed in the light of petitioner's prior conduct in this proceeding, the disingenuous nature of its attempt to deprive bondholders of the security for their bonds is apparent. In this very case, both petitioner and attorneys representing petitioner applied for and were awarded allowances for services and expenses (see *In re Prudence-Bonds Corporation*, 122 F. [2d] 258, 265), including services and expenses in 1935 in opposing accounting suits brought by bondholders in the State Courts (R. 431-433). These suits, as we have seen, were subsequently enjoined by the bankruptcy court (R. 427-430) and some were later discontinued (R. 433). They had been "vigorously" opposed by petitioner and its attorneys upon the ground, among others, as petitioner's own attorneys stated in their petition herein for an allowance, "that the proper forum for an accounting was in the reorganization proceedings of Prudence-Bonds Corporation" (R. 431). Now petitioner says that the State Court is the proper forum for any accounting suit, but that the six-year Statute of Limitations (New York Civil Practice Act, Sec. 48), which petitioner says has been running meanwhile, would apply to any objections.

a case the trustee is liable only to those persons who owned a bond or bonds on the date or dates of the trustee's wrongs; that neither those bondholders nor a successor trustee has any right to maintain a class or representative suit against the recreant trustee for the benefit of the trust fund; that the only remedy available to any such bondholder is to sue the trustee in an individual action at law for such an amount of damages as the individual bondholder could establish he personally suffered; and that any sum recovered in such an action would not go back into the depleted trust fund, but would belong solely to the bondholder bringing the action.

A moment's reflection upon the position taken by petitioner should show that, if upheld, it would, as the Circuit Court of Appeals stated, work "the most perfect injustice" (R. 523). If any such principle were adopted the long established power and jurisdiction of courts of equity to protect, preserve and enforce trusts would cease to exist. Any such rule would place in the hands of a trustee a power to destroy and terminate a trust and frustrate the purposes for which it was created. He could part with the trust fund, or a part thereof, and the bondholders or beneficiaries would be powerless to compel him to return to the fund the equivalent of the wrongfully diverted trust property so that it might continue to be held upon the trusts specified.

The Circuit Court of Appeals, after a careful analysis of the cases relied upon by petitioner, stated that the New York decisions "countenance no such unhappy result" (R. 524).

On the former appeal, the Court below held that the liability of the Corporate Trustees of the Debtor's bond issues for any diversion or waste of the Trust Funds would be to "restore the waste of assets" or to "restore the *res*" and that the recoveries on the objections "will in any event be part of the security" (*Central Hanover Bank & Trust Com-*

*pany, Trustee, et al. v. President and Directors of the Manhattan Company, Trustee, et al., supra).*

In the decision now sought to be reviewed, the Court below has again held it to be immaterial that the Trustee did not personally profit by the wrongful diversions of the trust *res*, or that some bondholders who owned their bonds at the time of the acts objected to have since transferred them to others. It has also held that petitioner's liability is to restore the Trust Fund and that such liability can be enforced on behalf of all bondholders.

These decisions are in accordance with basic principles of the law of trusts long established in New York and elsewhere. As long ago as *May v. Le Claire*, 11 Wall. 217, this Court, in ordering an accounting, held that if restoration of the specific trust property is impossible, the court may compel the trustee to "account for its present value" (11 Wall. 217, 237). That principle was applied in *Isenberg v. Trent Trust Co.*, 31 F. (2d) 553 (on rehearing of same case, 26 F. [2d] 609); cert. den. 279 U. S. 869. There the trustee had wrongfully failed to reduce to possession certain stock forming part of the trust estate. On an accounting by the trustee, it was held that the beneficiaries were entitled to restoration of the lost trust property in kind or to its value, the Court stating that this rule is "abundantly supported by authority" (31 F. [2d] 553, 555).

This principle was also applied to a trust securing a corporate bond issue in *Cherry v. Howell*, 66 F. (2d) 713, a representative suit in equity brought by two Class D bondholders of the Southern Guaranty Loan Company on behalf of themselves and all other Class D bondholders against directors of that company. It was alleged that the loan company diverted various funds held by it as trustee for the bondholders and that the directors sued were liable because they committed and caused the trustee to commit the alleged wrongful diversions of the trust property. The Court held that the trustee was a necessary party because "the liability which resulted was to replenish the fund so that it might continue to be held upon the trust specified"

and because "any recovery will be for the benefit of the trust estate as such and not for the benefit of the plaintiff personally" (66 F. [2d] 713, 716). In that case the Circuit Court of Appeals relied upon, among other cases, the case of *Western R. R. Co. v. Nolan*, 48 N. Y. 513.

The law as enunciated in the foregoing cases has long been the settled law of the State of New York (*O'Beirne v. Bullis*, 80 Hun 570, *affd. sub nom, O'Beirne v. Allegheny & Kinzua R. R. Co.*, 151 N. Y. 372; same case on second trial as to certain defendants, *O'Beirne v. Bullis*, 2 App. Div. 545, *affd.* 158 N. Y. 466, *rearg. den.* 158 N. Y. 719; *Harvey v. McDonnell*, 113 N. Y. 526; *Harrison v. Union Trust Co.*, 80 Hun 463, *affd.* 144 N. Y. 326; *Weetjen v. St. Paul & Pacific R. R. Co.*, 4 Hun 529; *Weetjen v. Vibbard*, 5 Hun 265; *Atlantic Trust Co. v. Crystal Water Co.*, 72 App. Div. 539; *Robinson v. Adams*, 81 App. Div. 20, *affd.* 179 N. Y. 558; *Smith v. Stevenson Brewing Co.*, 117 App. Div. 690; *Agne v. Schwab*, 123 App. Div. 746; *Hart v. Goadby*, 138 App. Div. 160; *Herrington v. Laimbeer*, 252 App. Div. 66). It has also been consistently applied in the Federal Courts (*Backer v. Levy*, 82 F. [2d] 270; *In re Dolcater*, 106 F. [2d] 30).

The right of a *cestui* to compel the replenishment of a trust fund is essentially a derivative one, because it is the trustee who is vested with legal title to the fund. Of course, where as here, a trustee comes into court and accounts, he is before the court in his representative capacity. And any beneficiary of an express trust may call the trustee to account (*Hart v. Equitable Life Assurance Society*, 172 App. Div. 659). Indeed, the *cestui's* right to an accounting does not in any way affect his right also to sue a fraudulent grantee or vendee (*Agne v. Schwab*, *supra*; *Noll v. Smith*, 250 App. Div. 453).

Suits for the benefit of a class are provided for by the New York Civil Practice Act (Sec. 195) and the Federal Rules of Civil Procedure (Rule 23). And in New York the rules respecting parties authorized to maintain repre-

sentative or class suits in equity are still the same as those established by the chancery courts (*McKenzie v. L'Amour-eaux*, 11 Barb. 516, cited with approval, *Brenner v. Title Guarantee & Trust Co.*, 276 N. Y. 230; see also *Atkins v. Trowbridge*, 162 App. Div. 629; *New York State Railways v. Security Trust Co.*, 135 Misc. 456).

The *O'Beirne* cases, *supra*, are direct authority for the proposition that in New York a holder of corporate bonds secured by a trust indenture has a derivative right to maintain a representative suit on his own behalf and on behalf of all other bondholders to compel the turning over to a mortgage trustee of the value of property which it had been agreed should be covered by the lien of the mortgage as security for bonds issued thereunder. Certain defendants there had agreed that various timber lands would be subjected to the lien of the trust mortgage. Plaintiff had demanded that the trustee bring suit to enforce the agreement and, on its refusal, commenced the suit on his own behalf and on behalf of all bondholders. Plaintiff's right to maintain the suit was strenuously contested. The New York Court of Appeals sustained his right to sue in such representative capacity to compel the specific performance of the agreement or "to compel the defendant to pay to the trustee, for the security of the bondholders, the value of said lands" (151 N. Y. 372, 377). It appearing that the defendants in question were not the owners of the land which they had agreed should be subjected to the lien of the mortgage, the decree provided for the payment of money to the trustee.\*

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\* The decree provided:

"That the defendants Spencer S. Bullis and Mills W. Barse at once pay to the Central Trust Company of New York the sum of \$292,125.00 with interest thereon at the rate of five per cent per annum from the first day of February, 1892, for the *pro rata* benefit of the plaintiff, James R. O'Beirne, and all other holders, of the first mortgage bonds of the defendant, The Allegheny and Kinzua Railroad Company" (*Matter of Bullis*, 68 App. Div. 508, 515-516).

Eight years had elapsed between the bringing of the suit and the affirmance of the final judgment against Bullis and Barse by the Court of Appeals. Still, the decree directed that the money substitute for the property be paid over to the trustee for the *pro rata* benefit of all bondholders. Thus the judgment inured to the benefit of all bondholders irrespective of when they acquired their bonds.

In *Zebley v. Farmers L. & T. Co.*, 139 N. Y. 461, the Court of Appeals held that the plaintiff, who was the owner of eleven bonds, was entitled to an accounting against a trustee who had improperly transferred property held by it as security for the bonds, even though it appeared from the complaint and arguments of counsel in the case that he had acquired his bonds subsequent to the alleged wrongful transfer of the trust property.\*

The rule of these cases has never been modified or overruled in New York, as we shall see in our subsequent discussion of the cases relied upon by petitioner. The *O'Beirne* cases, *supra*, go much further than is necessary to support the order below. The property there involved never had actually been in the trust fund; here, the petitioning Trustee is charged with wrongfully handing over securities and cash constituting a part of the Trust Fund in violation of express provisions of the Trust Agreement.

The New York courts traditionally have given to corporate trust bonds "every practicable facility as the basis of commercial transactions" (*Reynolds v. Title Guarantee & Trust Co.*, 240 N. Y. 257, 262). It is also well established law both in New York and in the Federal Courts that, in equity, the security follows the debt (*Vail v. Foster*, 4 N. Y. 312; *Chapman v. Brooks*, 31 N. Y. 75; *Craig v. Parkis*, 40 N. Y. 181; *Central Trust Co. of N. Y. v. N. Y. Equipment Co.*, 87 Hun 421; *Edwards v. Bay State Gas Co.*, 184

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\* The complaint had alleged: "That this plaintiff and the holders of said eleven bonds had no notice of \* \* \* said transfer \* \* \*"  
(Record on Appeal, p. 9, *Zebley v. Farmers L. & T. Co.*, *supra*).

Fed. 979; *Virginia Ry. & Power Co. v. Davis*, 284 Fed. 479, cert. den. 260 U. S. 746; *Colebrooke on Collateral Securities*, Sec. 79; C. J. S. Bonds, Sec. 74). In *Virginia Ry. & Power Co. v. Davis*, *supra*, the Court stated (284 Fed. 479, 481):

"It makes no difference whether Davis acquired the bonds before or after the diversion. The assignment of the bonds, whenever made, carried with it all the security provided by the mortgage and all the rights, interests, and remedies of the mortgagee. Davis, as assignee, had the right to follow the mortgaged property wherever found, except in the hands of a purchaser for value without notice. 3 Pomeroy's Eq., Sec. 1210; *Chicago, M. & St. P. Ry. Co. v. Third Nat. Bank*, 134 U. S. 276, 10 Sup. Ct. 550, 33 L. Ed. 900; *Shields v. Ohio*, 95 U. S. 319, 24 L. Ed. 357; *Fosdick v. Schall*, 99 U. S. 235, 25 L. Ed. 339; *Linder v. Hartwell R. Co.*, (C. C.), 73 Fed. 320; *Zinn v. Denver Livestock Com. Co.*, 68 Colo. 274, 187 Pac. 1033."

Not only is it an established principle of equity that the security follows the debt; in this case the principle is written into the Trust Agreement in clear unmistakable language. It provides that it was made in consideration of "the purchase and acceptance from time to time of said Prudence-Bonds by the holders thereof" (R. 25). It also provides that the Trust Fund is for the equal and *pro rata* benefit and advantage of all bonds, irrespective of when the securities and cash "constituting" the Fund (R. 26), were deposited with the Trustee and irrespective of the actual date of the issuance and negotiation of the bonds (R. 25, 26, 37, 43, see *supra*, p. 4).

If the right to compel a trustee to restore a wrongfully depleted trust fund to its proper level as constituted by a trust agreement did not follow the security and run with the bond, no one could rely upon a trust agreement or a trustee and no one would be safe in selling or purchasing a collateral trust bond until he first went to the trustee and made an investigation of all acts of the trustee with respect to the trust fund from the inception of the trust. If peti-

tioner's contentions were correct, and a person purchased a Prudence bond today, and yesterday the Trustee dissipated the entire Trust Fund, the new bondholder would have no security whatever for his bond and no right to complain of the Trustee's wrong. As the Circuit Court of Appeals stated (R. 524):

" \* \* \* For the truth is—whatever may be said as to other breaches—that whatever remedy the law gives for an actual depletion of the *res* as against a mere injury to it—is a substitute for the very subject matter of the transfer itself; and that, unless it passes to the assignee, the transfer has been frustrated, as would very plainly appear if the trustee had parted with the whole *res*. That we should not so construe the intent of the parties as to foil their venture, is a cardinal principle of all interpretation."

The authorities discussed above dispose of petitioner's argument that in New York a trustee who has wrongfully parted with trust property cannot be compelled to restore the trust fund. They also dispose of its argument that a holder of a corporate trust bond has no interest in any such recovery if he did not own his bond at the time of the trustee's wrongful depletion of the trust fund.

It is obvious that the decision below is in accordance with the law of New York governing the liability of a trustee of an express trust, whether it be a trust securing an issue of corporate bonds or for some other purpose. Indeed, in *Elkind v. The Chase Bank*, 259 App. Div. 661, 665, aff'd no op. 284 N. Y. 726, one of the cases principally relied upon by petitioner (R. 522), the Court clearly recognized the distinction between the suit then before it and a representative suit by a bondholder to compel restoration of a trust *res* by stating that the suit in the *Elkind* case was unlike "a suit to recover property that was subject to the lien of the mortgage".

The cases principally relied upon by petitioner are *Mittlemann v. President etc. of Manhattan Co.*, 248 App. Div. 79, aff'd no op. 272 N. Y. 632; *Weil v. President etc. of*

*Manhattan Co.*, 275 N. Y. 238; *Rabinowitz v. President etc. of Manhattan Co.*, 275 N. Y. 453; *Hendry v. Title Guarantee & Trust Co.*, 255 App. Div. 497; *Elkind v. The Chase Bank*, *supra*, and *Emmerich v. Central Hanover Bank & Trust Co.* (not officially reported), Sup. Ct., N. Y. Co., N. Y. Law Journal, March 10, 1942, p. 1040. Each of these cases was carefully considered and distinguished by the Circuit Court of Appeals, with the exception of the *Emmerich* case, which had not yet been decided (R. 520-525).

The *Weil*, *Rabinowitz* and *Mittlemann* cases involved certificate issues of New York Title & Mortgage Company. They were actions at law by "Schackno Act" \* Trustees, having limited statutory powers. The object of the action in each case was to recover damages for alleged torts of the defendant, with whom the Title Company had deposited various bonds and mortgages, against which mortgage certificates representing undivided shares therein has been assigned to certificate holders. The defendant bank was a mere depository and agent for the certificate holders. It was not a trustee and did not have and never had legal title to the deposited bonds and mortgages (*Matter of People* [Title & Mtg. G. Co. of Buffalo], 264 N. Y. 69, affirming 149 Misc. 643; *Matter of People* [New York Title & Mtg. Co.], 264 N. Y. 475; *Title G & T. Co. v. Mortgage Comm.*, 273 N. Y. 415; *Matter of New York Title & Mtg. Co.*, 241 App. Div. 351; *Matter of Lawyers Westchester Mtg. & T. Co.*, 247 App. Div. 895; *Abrams et al. v. Title G. & T. Co.* (not officially reported), Sup. Ct., N. Y. Co., N. Y. Law Journal, May 9, 1942, p. 1978; *Wiltzie on Mortgage Foreclosures* (1939), Vol. 1, p. 492).

The petitioner erroneously asserts that in the mortgage certificate cases relied upon by it, the question whether the defendant was a trustee or not had no part in the *ratio decidendi* of the cases and was not regarded as of any significance. In the *Weil* case, the attorneys for the defend-

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\* N. Y. Unconsolidated Laws, Secs. 1796 *et seq.*, L. 1933, c. 745, as amended.

ant placed considerable reliance upon the fact that in these, and in other cases involving mortgage certificates, title to the deposited bonds and mortgages had not been assigned or transferred to the defendant. A considerable portion of their brief was devoted to showing that the defendant was a mere depositary and not a trustee, that its rights and liabilities as depositary were not to be governed by the rules applicable to trustees of express trusts, and that since the defendant bank was not a trustee but merely a depositary, custodian or bailee, no action for an accounting would lie against it (*Weil* case, *supra*, Record on Appeal, pp. 74-78, defendant-respondent's brief). The Court of Appeals agreed and so held, stating (275 N. Y. 238, 243):

"In the action at bar the defendant was not the owner of the mortgages deposited with it. Neither was it a trustee of the mortgages deposited." \*

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\* It is only after reorganization in proceedings under the "Schackno Act", *supra*, or the "Mortgage Commission Act" (New York Unconsolidated Laws, Sec. 1751 *et seq.*, L. 1935, c. 19, as amended), that the bonds and mortgages in which certificate holders had undivided interests are held by trustees. Upon reorganization, each certificate issue is operated under a separate standard form declaration of trust. The certificates are held by over 200,000 investors, the corpus of these trusts exceeds \$700,000,000 and their administration in and about the City of New York is lodged in the hands of over 250 trustees appointed by Justices of the New York Supreme Court. These trustees must account to the court annually and upon objections to their accounts they have, on occasion, been surcharged and ordered to reimburse the estate with the amount of the surcharge. The mortgage certificates are dealt in on the open market and change hands daily and it is quite obvious that many persons who are certificate holders at the time of the trustee's annual accounting were not certificate holders at the time of a wrongful disbursement or other act of a trustee which subjects him to a surcharge. And it is also manifest that a person acquiring a certificate the day before a surcharge is paid into the estate obtains the benefit thereof. No one has yet suggested in the New York courts that these trustees are liable only to certificate holders who owned their certificates on the day a trustee made an improper disbursement or otherwise depleted the trust estate. Quite the contrary, these trustees are treated like any other trustee of an express trust (see Article entitled "The Administration of Guaranteed Mortgage Trusts," and cases cited therein, N. Y. Law Journal, January 6, 1942, p. 58, January 7, 1942, p. 76, and January 8, 1942, p. 96).

Petitioner's contention that the Circuit Court of Appeals misinterpreted the *Weil* and *Mittlemann* cases is further refuted by the recent decision of the New York Court of Appeals explaining its decisions in those cases, pointing out, among other things, that those actions "were brought to enforce tort liabilities" (*Matter of People [Lawyers West. Mtg. & Title Co.]*, 288 N. Y. 40, 47).

The *Hendry* case, *supra*, related to a mortgage certificate issue of Title Guarantee and Trust Company. The certificates there involved also created a legal relationship distinctly different from the legal relationship created by the bonds, Trust Agreement and Trust Fund here involved. A mortgage certificate of Title Guarantee and Trust Company is not a secured promise to pay; it is an assignment of an undivided share in a mortgage. Holders of such certificates are merely "tenants in common, each entitled to an aliquot share of the mortgage referred to in the certificate" (*Title G. & T. Co. v. Mortgage Comm.*, 273 N. Y. 415, 422). The relationship between the Title Company and the certificate holders was not that of trustee and cestui que trust (see cases cited *supra*, p. 22). Legal title to the underlying mortgage, although originally acquired and held by the Title Company, was, by the issuance of mortgage certificates, assigned in aliquot shares to the certificate holders, who then became tenants in common of the legal title to the mortgage. The Title Company, as provided in the mortgage certificates, merely held the mortgage documents as "agent and depository" for the certificate holders (cf. *Fisher v. Title G. & T. Co.*, 176 Misc. 166, *affd.* 262 App. Div. 293, *affd.* 287 N. Y. 275). There was no trust fund and the legal relationship between the Title Company and the certificate holders was only such as exists between an assignor and assignee or principal and agent.

Furthermore, mortgage participation certificates of Title Guarantee and Trust Company, unlike Prudence-Bonds, did not pass from hand to hand by delivery or assign-

ment (R. 357, 370). The mortgage certificates in the *Hendry* case, in the usual form of Title Guarantee and Trust Company certificates, specifically provided (see *Title G. & T. Co. v. Mortgage Comm.*, 273 N. Y. 415, 420):

"This certificate is not negotiable. The only way that the interest of the purchaser can be transferred is by the surrender of this certificate to the Company duly assigned and the issuing of another certificate to the transferee." \*

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\* In the *Hendry* case, the attorneys for the defendant Title Company argued with respect to the two certificate holders who had acquired their certificates after the time of the defendant's wrong (Record on Appeal, 255 App. Div. 497; Defendant-Appellant's Brief, pp. 13-14):

"It is obvious that when their certificates were purchased the purchasers took a participation in the mortgage as it existed at that time. Their rights were in no sense derivative. At that time a portion of the original mortgaged premises had already been released and the mortgage had been extended to cover the remaining premises. These two plaintiffs, or their predecessors then, purchased their certificates in a mortgage on specifically identified property and defendant committed no act to injure their security after their purchase.

"To hold to the contrary would mean that when defendant sold the two certificates referred to, it assigned at the same time a cause of action against itself to recover 7/10ths of the purchase price. Such a result, of course, is absurd. It is clear that defendant acquired the participation in the mortgage which it sold to these two plaintiffs from the former certificate holders who had turned in their certificates upon the extension of the mortgage on January 8, 1930 (see fol. 170). While the former certificate holders may have held a cause of action against defendant for the acts stated in the complaint, any such cause of action was immediately extinguished, in accordance with the theory of merger, when defendant reacquired their participations in the mortgage."

The decision of the Appellate Division in the *Hendry* case was affirmed without opinion by the Court of Appeals, but the unsuccessful certificate holders had not appealed to that Court (280 N. Y. 740).

Thus, when a certificate was transferred back to the Title Company and then to a new certificate holder, a new relationship of assignor and assignee and of principal and agent was created; the Title Company being the assignor or agent and the certificate holder the assignee or principal. Each certificate holder, having acquired his certificate by assignment direct from the Title Company, would have no cause of action against his agent for a wrong which his agent committed to some other principal.

In *Matter of 22-52 44th Street, Long Island City*, 176 Misc. 249, the Court held that upon an assignment of a mortgage participation certificate of the Greater New York Suffolk Title & Guarantee Company, all rights which an assignor had in the security and collateral passed to an assignee in the absence of an express reservation by the assignor, and stated that "this conclusion seems to find ample support in cases relating generally to the assignment of a contractual right" (p. 254). The Court in that case pointed out that the decision in the *Hendry* case was reached upon the authority of other cases which were "decided on the theory that under the facts and circumstances involved *it was not intended by the parties to transfer the rights of action for the previous breach*" (p. 253). (Italics the Court's.)

With these principles and legal distinctions in mind, it becomes clear that the holding in the *Hendry* case to the effect that a certificate holder had no cause of action against the Title Company for a breach of a fiduciary obligation, unless he held his certificate at the time of the act complained of, is not here applicable. As stated by this Court in *McCandless v. Furland*, 296 U. S. 140, 163: "Confusion of thought is inevitable unless the position of the wrongdoers as trustees is steadily kept in mind."

The *Elkind* case, *supra*, clearly indicates the difference in New York between the rules applicable to suits for breaches of fiduciary obligation giving rise to a personal tort cause of action at law for damages and a claim on

behalf of beneficiaries of a trust to recover on behalf of the trust fund for the wrongful act of a trustee resulting in a depletion of the trust fund.

The plaintiffs in the *Elkind* case, unlike respondents here, were seeking to compel the defendant trustee to account for money and property which had never been, and never was intended to be, part of the trust fund securing plaintiffs' bonds. The Circuit Court of Appeals clearly distinguished the *Elkind* case and it is unnecessary to add to what they have said (R. 522-524).

The opinion of the Court in the *Emmerich* case, *supra*, is set forth in an appendix to petitioner's brief. The case came up on a motion to dismiss the complaint. The opinion does not state the nature of the action and does not set forth any facts alleged in the complaint. However, an examination of the complaint in the office of the Clerk of New York County discloses that the case was an action for damages brought by the plaintiff individually and not on behalf of all bondholders against the defendant individually and not as trustee. Plaintiff was seeking a personal judgment in his favor. He did not seek the restoration of the trust *res*. The decision is of doubtful validity and, although the facts are somewhat obscure, it would appear to be in conflict with the decision of the New York Court of Appeals in *Zebley v. Farmers L. & T. Co.*, *supra*, which was neither cited by the attorneys for any of the parties nor mentioned in the opinion of the Special Term Justice.

None of the cases relied upon by petitioner in any way detract from the force of the decisions of the New York Court of Appeals in the *O'Beirne* and other cases to which we have referred and there is not the slightest conflict between the decision of the Circuit Court of Appeals and the law of New York governing the liability of a trustee of an express trust in the circumstances here.

## II

**The Circuit Court of Appeals has correctly held that the objections are not barred by any statute of limitations.**

In New York the rule is well settled that time does not run against an express trust until open repudiation or adverse possession by the trustee and knowledge thereof on the part of the *cestuis* or until the Trustee invokes the aid of the Court to pass upon his accounts. The Circuit Court of Appeals followed this well-established doctrine (R. 525). The petitioner, however, complains that it cited only one case as an authority, viz., the case of *Ludington v. Thompson*, 153 N. Y. 499. But this rule has long been established law and it is based upon the principle that a trustee does not hold a trust fund adversely to the *cestuis* but in possession for their benefit. This rule was restated and followed as long ago as *Oliver v. Piatt*, 3 How. 333, 411, a landmark in the law of trusts. It has consistently been followed ever since. In *Anderson v. Fry*, 116 App. Div. 740, 742, the Court stated, "no citation of authority is required upon the proposition that mere lapse of time does not bar an action for accounting against a trustee of such a trust."

Numerous other cases could be cited, only a few of which are *Davis v. Davis*, 86 Hun 400; *Matter of Sack*, 70 App. Div. 401; *Lammer v. Stoddard*, 103 N. Y. 672; *Zebley v. Farmers L. & T. Co.*, *supra*; *Spallholz v. Sheldon*, 216 N. Y. 205; *Gisborn v. Charter Oak Ins. Co.*, 142 U. S. 326; *Brown-Crummer Inv. Co. v. City of Miami*, 40 F. (2d) 508; *Merritt Oil Corp. v. Young*, 43 F. (2d) 27; *Norfolk and W. R. Co. v. Bd. of Ed.*, 14 F. Supp. 472; *Seelig v. First Nat. Bank of Chicago*, 20 F. Supp. 60; *Perry on Trusts* (7th Ed.), Vol. 2, Sec. 863.

There is also no merit to petitioner's suggestion that the doctrine that time does not run against an express trust

does not apply to trustees acting under trust agreements or trust indentures securing corporate bond issues. *Zebley v. Farmers L. & T. Co.*, *supra*, related to the wrongful acts of a trustee under a trust mortgage securing a railroad bond issue. In that case the Appellate Division had sustained a demurrer to the plaintiff's complaint (*Zebley v. Farmers L. & T. Co.*, 63 Hun 541). Judge O'Brien, dissenting from the majority opinion of the General Term, stated (pp. 549-550):

"We have always regarded it as elementary that a *cestui que trust* had a right to demand of a trustee an accounting as to the administration of his trust; and in this respect there can be no distinction between the trustee of a railroad company and any other trustees, for the reason that the former are governed by the general rules that govern trustees in the ordinary performance of the duties of a trust."

The Court of Appeals, in reversing the majority of the General Term and sustaining the view of the dissenting Judge, stated (139 N. Y. 460, 469):

"Generally the obligation of a trustee to account is not affected by the Statute of Limitations until a denial or repudiation of the trust (Perry on Trusts, vol. 2, sec. 863; Angell on Limitations, secs. 166, 468, 472; *Decouche v. Savetier*, 3 Johns Ch. 190, 216; *Flint v. Bell*, 27 Hun 158; *Shannon v. Howell*, 36 id. 47)."

As stated in Perry on Trusts (7th Ed.), vol. 2, sec. 760:

"Trustees for bondholders are governed by the general rules that govern trustees in the ordinary performance of the duties of a trust."

Petitioner relies upon the case of *Rhineland v. Farmers Loan & Trust Co.*, 172 N. Y. 519, as an authority for excepting the trust here involved from the doctrine that time does not run against an express trust. The plaintiff in that case did not urge this doctrine and it is not mentioned

in the opinion of the Court of Appeals. Moreover, in that case, the defendant trustee never released or gave up any part of the lien of the trust mortgage which had been made to it by the railroad company, it never had possession of any part of the proceeds of the bonds, the proceeds of the mortgage, and it never acquired title to the mortgaged property, as did the defendant trustee in *Zebbley v. Farmers L. & T. Co.*, *supra*. In the *Rhineland* case, therefore, no case could have been made for an accounting (cf. *Harrison v. Union Trust Co.*, *supra*).

### III

**The bankruptcy court in a corporate reorganization proceeding has undoubted jurisdiction over the objections to petitioner's account.**

Petitioner's present contention that the bankruptcy court has no jurisdiction to pass upon the objections to its account was not raised in the Circuit Court of Appeals on the appeal which resulted in the order now sought to be reviewed. When its motion was made before the District Court, petitioner filed an affidavit in which it stated, "we have never and do not now question such jurisdiction" (R. 246). In the Circuit Court of Appeals on the appeal from the denial of its motion, petitioner expressly excluded the question of jurisdiction from the issues on appeal (R. 505), and in its brief on appeal again represented to the Court that, "We never have and do not now question the correctness of the decision of this court in upholding the jurisdiction of the district court with respect to this accounting proceeding" (R. 244-245). The decision to which petitioner referred was the decision of the Circuit Court of Appeals on the former appeal in this reorganization proceeding upholding the jurisdiction of the bankruptcy court over the accounts of the Corporate Trustees and objections

thereto (*Central Hanover Bank & Trust Co. et al. v. President and Directors of the Manhattan Co. et al.*, *supra*).<sup>\*</sup> Petitioner was an appellee on such appeal (R. 447), but neither petitioner nor any of the other Corporate Trustees (two of them were appellants) petitioned this Court for certiorari.

In the circumstances here, we submit that the jurisdiction question presents no ground for a review of this interlocutory order, especially as the record on which the Circuit Court of Appeals upheld the jurisdiction of the bankruptcy court, although incorporated into the present record by reference (R. 203), has not been presented as a part of the record here.

It is clear, however, that the bankruptcy court has jurisdiction to pass upon the objections filed on behalf of the bondholders. Petitioner's position here that the bankruptcy court is without jurisdiction stems from its erroneous assumption that the recoveries on the objections will not go back into the trust fund or *res in custodia legis*, but will belong solely to certain individual bondholders. Petitioner's further contention that in any event the right, arising out of the acts objected to, to compel restoration of the trust *res* would not constitute property of the Debtor within the meaning of the Bankruptcy Act, is unsound as the Circuit Court of Appeals has twice demonstrated in this very case; first by its decision on the former appeal, and again by its decision which petitioner now seeks to review (see also *In re 1775 Broadway Corp.*,

<sup>\*</sup> When the issue of jurisdiction was raised in November, 1938 (R. 414), petitioner, as it later stated in an affidavit, "vigorously supported the proposition that this Court had complete jurisdiction" (R. 244). It filed a supporting affidavit (R. 244) and its attorneys argued in support of jurisdiction (R. 419). While the District Court Judge was deliberating on the issue, petitioner, upon an affidavit of its counsel, obtained an ex parte order permitting it to withdraw its supporting affidavit (R. 244-245). Petitioner in another affidavit later explained this action on its part as taken to co-operate with other Corporate Trustees "who appeared to have more at stake," but that petitioner "did not question the jurisdiction of this Court at any time to compel a complete accounting by the corporate trustees" (R. 244).

79 F. [2d] 108; *In re Nine North Church Street*, 82 F. [2d] 186). On the former appeal the Circuit Court of Appeals analyzed and rejected petitioner's present suggestion that because the Debtor was a participant in the wrongful acts objected to, the recoveries would not constitute property of the Debtor within the meaning of the Act (105 F. [2d] 130). That decision is not in conflict with any decisions of other Circuit Courts of Appeals and is supported by the decision of this Court in *McCandless v. Furland*, *supra*. It is also fully supported by specific provisions of the Bankruptcy Act and decisions under the Act.

In 1935 the Circuit Court of Appeals, following the decision of this Court in *Continental Bank v. Rock Island Ry.*, 294 U. S. 648, upheld the jurisdiction of the bankruptcy court over the Trust Fund collateral securing the Debtor's eighteen Series of Bonds (*In re Prudence-Bonds Corporation*, 77 F. [2d] 328, cert. den. 296 U. S. 534; see also *In re Prudence-Bonds Corporation*, 75 F. [2d] 262; *In re Prudence-Bonds Corporation*, 79 F. [2d] 205, cert. den. 296 U. S. 652). Subsequently, the reorganization court determined that the Debtor was insolvent (R. 370). The plans were then confirmed and the "general claimants and the stockholders of the Debtor were excluded from participation" (R. 334), in accordance with established precedents in similar situations (*In re 620 Church St. Corp.*, 299 U. S. 24; *In re Witherbee Court Corporation*, 88 F. [2d] 251, cert. den. 301 U. S. 701).

The rehabilitation of secured debts was a primary purpose of Section 77B of the Bankruptcy Act. The jurisdiction of the bankruptcy court to confirm a plan of reorganization extends to collateral securing the claims of secured creditors, though the Debtor's equity has lost all value (*In re Central Funding Corp.*, 75 F. [2d] 256) and though the Debtor has conveyed away its equity "long before the proceeding was started" (*In re Mortgage Securities Corp.*, 75 F. [2d] 261, 262).

In the instant case, the District Court in confirming the Plans reserved jurisdiction to give such further authorizations or directions with regard to the Plans and the property dealt with by the Plans as might be necessary to carry out and consummate the Plans (R. 372-373). It thereafter, by various orders, provided a method to make effective, consummate and carry out the Plans (R. 378-387). The steps provided for, as we have shown above, were the formation of a New Corporation, an authorization and direction to the Debtor and its 77B Trustees to assign all their right, title and interest in the Trust Fund collateral to the New Corporation, the approval of Modified or Supplemental Trust Agreements, an authorization and direction to petitioner and the other Trustees under the original Trust Agreements to assign, convey and deliver the Trust Fund collateral to the Successor Trustee and, finally, an authorization and direction to the Trustees under the original Trust Agreements to account in the reorganization proceeding for their respective acts and proceedings as Trustees. This authorization and direction to account was contained in the orders approving the Supplemental Trust Agreements (R. 380, 383-384).

It quite plainly appears that these steps were inter-related, orderly and necessary to make effective and carry out the plans. They were taken and provided for in accordance with the plans and the mandate of Section 77B (b) (9) that a plan, within the meaning of the section, "shall provide adequate means for the execution of the plan". Indeed, the order of the District Court taking jurisdiction over these accounts and objections specifically provides that jurisdiction was taken "to make effective, consummate and carry out" the Plans (R. 206).

Manifestly, the superseded Corporate Trustees had both a right and an obligation to account to the reorganization court which had modified the Trust Agreements, appointed a Successor Trustee and provided for the transfers of the Trust Fund collateral to the new Trustee. And the power

of the bankruptcy court to settle the accounts and pass upon the objections thereto was fully provided for by the Bankruptcy Act. Section 77B (b) (10) specifically provided that the Court could enforce an accounting under a trust indenture. Section 77B (b) (9) provided that adequate means for the execution of the plan may include "the satisfaction or modification of liens, indentures, or other similar instruments". Section 77B (h) further provided that upon confirmation of a plan the Court may direct "the trustee of any obligation of the debtor" to make any necessary transfer or conveyance of the property dealt with by the plan. Standing alone, the power to satisfy a trust indenture implies the necessary incidental power to take a complete accounting (Cf. *Glenny v. Langdon*, 98 U. S. 20, 25).

And it is manifest that the power to take an accounting would be ineffectual, unless the Court also had the power to pass upon objections to an account.

Chapter X amplified rather than restricted the jurisdiction of a reorganization court over indenture trustees (Secs. 126, 170, 198, 206, 212, 227).

It clearly appears, therefore, that the jurisdiction issue raised by petitioner does not present any important question of bankruptcy law requiring determination by this Court.

**CONCLUSION**

**The petition should be denied.**

Respectfully submitted,

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